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TN REGULATORY AUTHORITY
DOCKET ROOM
October 21, 2002

VIA HAND DELIVERY

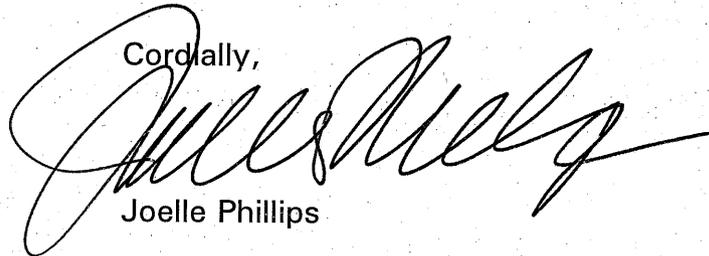
The Honorable Sara Kyle, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243

Re: *Proposed Rules for the Provisioning of Tariff Term Plans and Special Contracts*
Docket No. 00-00702

Dear Chairman Kyle:

Enclosed are the original and fourteen copies of the Final Report of BellSouth Telecommunications, Inc. Regarding Negotiation Relating to Contract Service Arrangements. Copies of the enclosed are being provided to counsel of record.

Cordially,



Joelle Phillips

JP/jej

Enclosure

cc: The Honorable Deborah Taylor Tate, Hearing Officer

**BEFORE THE TENNESSEE REGULATORY AUTHORITY
Nashville, Tennessee**

**In Re: *Proposed Rules for the Provisioning of Tariff Term Plans and Special Contracts*
 Docket No. 00-00702**

**FINAL REPORT OF BELL SOUTH TELECOMMUNICATIONS, INC.
REGARDING NEGOTIATION RELATING
TO CONTRACT SERVICE ARRANGEMENTS**

BellSouth Telecommunications, Inc. ("BellSouth") files this Report pursuant to the instruction of the Hearing Officer in this docket, in order to inform the Hearing Officer of the development of issues relating to the above referenced docket. BellSouth respectfully shows the Hearing Officer as follows:

INTRODUCTION

BellSouth, along with the other interested parties active in this docket, has participated in several meetings and exchanged correspondence to address issues relating to Contract Service Arrangements. These issues centered upon the concerns set forth in the May 31, 2002 letter from the Attorney General's Office relating to proposed new rules for Contract Service Arrangements. While that letter indicated that the Attorney General declined to approve the new rules based upon concerns regarding the Public Records Act, the letter went on to discuss, in "dicta," more general concerns about Contract Service Arrangements. The Attorney General noted that, in this environment of increased competition, certain tariffing requirements were loosening. Nevertheless, he expressed concern that

certain statutes (enacted prior to telecommunications competition), may be at odds with the approval, on a routine basis, of Contract Service Arrangements departing from tariff rates, solely to address competition. While BellSouth disagrees with this position, BellSouth recognizes that this concern will need to be addressed in this docket.

The Attorney General's concerns relate to the fundamental reason (namely, competition) that carriers enter into Contract Service Arrangements. Recognizing this, carriers interested in this proceeding, along with the Consumer Advocate Division of the Attorney General's Office, have met to brainstorm about possible solutions that would address the Attorney General's concerns, allow all carriers to fully compete in the current environment, and deliver the benefits of competition (lower, competitive prices) to customers in Tennessee. In evaluating these issues, it has become clear that the vast majority (approximately 90%) of the CSAs that BellSouth submits to the TRA address discounts for the same five business services as well as volume and term agreements. These five business services are consumed by business customers with sophisticated needs. As to the five services, BellSouth has found that these business customers, presented with competitive alternatives, are interested in (and expect) negotiated agreements that deliver competitive prices. Consequently, BellSouth has focused on these specific business services in trying to find a workable solution.

The parties have not reached unanimous agreement as to the appropriate manner in which to address these issues, but many of the interested parties have

formed consensus that an appropriate resolution to this issue may be achieved through the use of T.C.A. § 65-5-208(b).

I. Operation of T.C.A. § 65-5-208(b).

Pursuant to T.C.A. § 65-5-208(b), the TRA is empowered to exempt a group of services from all or a portion of the requirements of Part 2, Chapter 5, Title 65 of the Tennessee Code (copy attached.) Such an exemption requires a finding that the public interest and the policies of the governing statutes would be served by such an order. Moreover, the statute specifically *requires* the TRA to exempt any telecommunications service for which *existing or potential* competition is an effective regulator of the price of those services. Among the provisions of Part 2 of Chapter 5 are the TRA's power to fix rates in §§ 65-5-201 and 203, the power to require the filing of tariffs in 65-5-202 and the prohibition against unjust discrimination and undue preferences in 65-5-204.

This statute reflects the policy of the General Assembly to embrace market competition, rather than to maintain regulation, when competition takes hold (or will take hold in the future) sufficiently to regulate prices of particular services.

It is important to note that this statute does not contemplate a complete abrogation of the TRA's jurisdiction over services it chooses to exempt. While the statute empowers the TRA, and in some circumstances directs the TRA as a mandatory statutory requirement, to exempt certain services from certain regulatory requirements, the statute also contains substantial safeguards and preserves for the TRA the ability to continue to monitor and respond to any anti-

competitive pricing of such services. Specifically, § 65-5-208(c) provides that the Authority shall, as appropriate, also adopt other rules or issue orders to prohibit cross-subsidization, preferences to competitive services or affiliated entities, predatory pricing, price squeezing, price discrimination, tying arrangements or other anti-competitive practices. Accordingly, the statute strikes an appropriate balance between moving toward a competitive market and away from regulation while at the same time maintaining the ability to regulate when necessary to address potential anti-competitive practices that could harm the competitive marketplace.

After studying this statute, and the issues raised by the Attorney General and others relating to CSAs, BellSouth believes the TRA should exempt five types of business services from the tariffing and price discrimination requirements found in Title 65, Chapter 5, Part 2. By doing so, the TRA will carry out the legislative mandate that it "shall" exempt services for which present or future competition is an effective regulator of price. Moreover, the TRA will use a method established by the General Assembly to respond to competition. Finally, by exempting these services, the TRA will free itself of the substantial burden of handling numerous CSAs for these services and be able instead to focus on the remaining, more unusual, CSAs. This would result in there being no need for new CSA rules as the existing (not proposed) rules would be sufficient to handle the remaining CSAs. Those existing rules were approved by the Attorney General when promulgated and would not need to be revisited.

II. Proceedings in the Current Docket.

Because the prospect of exemption of certain business services bears so clearly upon the need for new rules, these issues should be considered in this docket. Specifically, BellSouth believes that the TRA cannot make a completely-informed decision as to the need (if any) for new rules without first considering facts supporting exemption.

BellSouth believes that, within the framework of the contested-case-style hearing planned in this docket, BellSouth and other carriers can present sufficient evidence from which the TRA could make a finding that existing and future competition is sufficient to regulate price for the following business services as well as volume and term contracts for business customers:

1. **Primary Rate ISDN Service (as defined in BellSouth Tariff A42.3):** Competitors¹ with BellSouth for this service include Adelphia, Aeneas Internet and Telephone, AT&T, DTI, ITC DeltaCom, MCI WorldCom, NEWSOUTH, Sprint, Time Warner, US LEC, and XO Communications.
2. **IntraLATA Toll (Saver Service and WatsSaver Service, as defined in BellSouth Tariff A20.3):** Competitors for this service include AT&T, MCI WorldCom, Sprint and Qwest.
3. **Central Office Based Premise Switching (Centrex, ESSX MultiServ, MultiServ Plus, as defined in BellSouth Tariffs A12.20, .21, .23, and A112):** In addition to PBX equipment and service offerings from Lucent, NEWSOUTH, Panasonic, Toshiba, Samsung and others, CLEC competitors include

¹ BellSouth submits these non-exhaustive lists of competitors for each of these five as a preliminary indication of competition. BellSouth expects that, after discovery, additional entities may be identified as competitors for each of the services listed as well as for volume and term agreements.

Adelphia, Birch, BTI, Nuvox, Time Warner, US LEC and XO Communications.

4. **High Capacity Transport (MegaLink Service, MegaLink Channel Service, MegaLink Plus Service, SMARTPath and SMARTRing Service, as defined in BellSouth Tariffs B7.1, .3, .7, .8, and .10):** Competitors offering this service include Aeneas Internet and Telephone, AT&T, Intermedia, NEWSOUTH, XO Communications, Electric Power Board of Chattanooga, Time Warner, US LEC, and MCI WorldCom.
5. **Data Services (Frame Relay, ATM, NMLI & SynchroNet) (as defined in BellSouth Tariffs A40 and B7.2):** Competitors for this service include AT&T and MCI.

For its part, BellSouth will present evidence regarding its awareness of competitive offerings for these services by CLECs and other providers. In addition, it is important to note that the roughly 500 BellSouth CSAs most recently approved by the Authority for these business services have included the "Tennessee Addendum." This Addendum, which BellSouth attaches to each of its CSAs, includes a declaration by the customer that the customer has received a competitive offer or is aware that comparable services are available from another carrier. Thus, each time the TRA has approved such a CSA it has implicitly recognized that competition existed for that customer for that service. BellSouth looks forward to presenting evidence about the level of competition as to these services in Tennessee and other facts that support exemption.

III. **Exemption Offers the Best Way to Address the CSA Issue.**

The services listed above, as well as billing arrangements for volume and term discounts for the business customers consuming such services, make up the

vast majority of BellSouth's Contract Service Arrangements. If such services were exempted pursuant to § 65-5-208(b), then the number of CSAs that BellSouth would request that the TRA approve would be drastically reduced. In short, it is the competition to provide these particular five business services that has driven BellSouth to seek to enter into Contract Service Arrangements for such services. When that competition is recognized and these services are exempted from the price regulation-related requirements as discussed above, contractual arrangements with business customers for these services will no longer require the current level of TRA review.

BellSouth recognizes that, with any reduced regulation, the Consumer Advocate and some CLEC competitors may raise concerns about the possibility for abuse. BellSouth urges that such concerns should not dissuade the TRA from following the statutory mandate contained in § 65-5-208(b). As noted above, § 65-5-208(c) includes significant safeguards to enable the TRA to continue to monitor and take action in the event that any carrier engages in anti-competitive activity. In order to give further comfort to address these concerns, BellSouth also proposes that the TRA order all carriers to provide a monthly summary style filing (similar to what CLECs currently file today) to inform the TRA of the agreements into which it enters regarding such services. This filing would enable the TRA to issue data requests from time to time in order to review the supporting cost documentation to ensure, for example, that BellSouth was not engaging in pricing

below its cost. Such a procedure is similar to the processes used in Kentucky and North Carolina.

In addition to concerns regarding abuse, competitors may also raise concerns regarding resale obligations imposed by federal law. BellSouth would continue to comply with applicable resale obligations. BellSouth is able to maintain and comply with its resale obligations throughout its nine state region even though many of those states do not require the filing of Contract Service Arrangements. As in those other states noted above, CLECs would be advised of the existence of a BellSouth CSA via the summary filing described earlier. Moreover, to date, even with the extensive filing requirements to make public these CSAs, BellSouth has received very few, if any, inquiries about resale of CSA pricing. Additionally, there has never been a complaint alleging that any carrier had been unable to resell a Tennessee CSA.

Some may argue that the way to address competition for these services is for companies like BellSouth to simply lower the price for these services in the tariff, making that lower price generally available to all. As an initial matter it is important to look at what the General Assembly has to say about that approach. Section 65-5-208(b) makes clear that the General Assembly's answer to competition is not further tariffing but rather the exemption from tariffing. In fact, the General Assembly has placed upon the TRA the mandatory duty to exempt services when it determines that the price of such services is effectively regulated by existing or future competition. That is exactly the case for these services.

Second, it is important to realize that lowering the tariff price to meet the competitive demands of today does not solve the problem for tomorrow. Finally, a reduction of the tariff pricing for these highly competitive business services would make continued competition more difficult for CLECs by reducing their margin.

Reducing the generally-applicable tariff price is simply a band-aid solution, with no lasting impact. Moreover, such an approach is flatly contrary to the way in which competitive markets operate. The intent of the General Assembly to foster such a competitive marketplace is clear.

Given the direction of the General Assembly, it is clear that the General Assembly wanted to see competition and expects that, when such competition is demonstrated, the TRA will respond using this statutory device to exempt those services from tariffing and other price regulation. During the more than six years that the Tennessee Regulatory Authority has been in existence, the Authority has never exempted a service using this statute, yet the Authority has continually reported to the General Assembly about the growing competition in Tennessee in telecommunications and particularly about competition relating to telecommunications services for business customers.² It is clearly time for the TRA

² *See, for example,* the TRA Annual Report for the period of July 2000 through July 2001, dated February 1, 2002, which states:

Still, Tennesseans are seeing significant competitive activity in the business segments of the local telecommunications markets despite a large number of new entrants that have declared bankruptcy, ceased operations or otherwise experienced significant financial difficulties

to respond to this legislative mandate, discard the old form of regulation and tariffing as to these five business services in exchange for the General Assembly's preferred plan of market driven prices for telecommunication services in Tennessee.

IV. Scheduling to Move Forward.

BellSouth has attached a proposed schedule for discovery, pre-filed testimony, hearing, and post-hearing briefs and comments.

It is appropriate that testimony relevant to competition and the proposed exemption of services should be heard by the entire TRA sitting as a rulemaking panel, because the decision whether or not to exempt such services under § 65-5-208(b) is relevant to whether or not new rules are needed. Specifically, in the event that the TRA decides to exempt the five business services identified herein under § 65-5-208(b), the existing CSA rules, not the proposed rules, would be sufficient to handle the remaining Contract Service Arrangements in light of the

from the dramatic decline in capital dollars now available to these new entrants. As of June 30, 2001, one hundred (100) facilities-based competitors were certificated to provide local telephone service in the state, with twenty-eight (28) of these providers offering services in Tennessee. These 28 competitors serve 335,598 lines in Tennessee, primarily business customers in the State's four (4) largest metropolitan areas. This represents 10% of Tennessee total lines open to competition and 28% of the business lines subject to competition. On June 30, 2001, new market entrants had invested \$489 million in equipment and facilities in Tennessee since the passage of these new laws. In contrast, on December 31, 1996 only six (6) facilities-based competitors were offering local telephone service in Tennessee, serving 300 lines. In 1996, competitors had invested \$56 million in equipment and facilities. Fifty-six (56) resellers are also providing local service to 33,480 lines. The majority of those lines are residential lines in the metropolitan areas.

dramatic reduction in number that would flow from the exemption. These existing rules have not been called into question by the Attorney General. BellSouth urges that the contested-case-style hearing, which has been discussed in this docket, is an appropriate forum in which to address issues related to exemption under § 65-5-208(b). The types of issues that the Consumer Advocate has raised (such as the availability of discounts to similarly-situated customers) would also be appropriate to be explored during such a hearing and also are relevant to exemption under § 65-5-208(b). In short, the hearing should be used to get all of these issues before the Authority.

Following a hearing, the parties should submit post-hearing briefs presenting argument regarding exemption under § 65-5-208(b) and addressing whether or not new rules are needed. In the event that parties believe that additional rules are needed, then their post-hearing briefs should include draft rules. These draft rules should not be submitted until after the hearing, however, in order to first bring clarity to the various issues raised by the Attorney General. The Authority should consider these issues in order to decide what it needs to accomplish with new (or old) rules. After the submission of those briefs and, if necessary, proposed rules, the parties should be permitted time to file reply comments prior to the TRA deliberating as to exemption under § 65-5-208(b) or the adoption of new rules. In addition to party comments, BellSouth believes the Staff should issue data requests focusing on the offering of such services by all regulated providers in Tennessee in

order to develop information regarding the competitive landscape for these services.

CONCLUSION

Exemption of services under § 65-5-208(b) will accomplish numerous goals. First, it will carry out the mandate of the General Assembly to respond to competition when it is demonstrated. Second, it will address the concerns raised by the Attorney General by providing an additional statutory basis for allowing the benefits of competition (in the form of competitive prices) to flow freely to Tennessee businesses and drastically reduce the number of CSAs. Finally, exemption of the services will address this issue in a manner that brings appropriate parity between ILECs and CLECs.

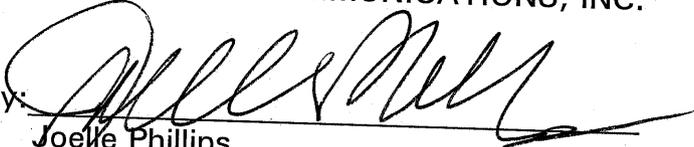
As a final matter, BellSouth wishes to note for the record that the time spent on negotiation regarding these issues has been extremely productive. While no unanimous decision was reached by the parties as to the appropriate way to proceed, the parties have exchanged a significant amount of information and were able to discuss their ideas and concerns in a fashion that would have been unlikely in the context of an adversarial proceeding.

Having spent this time discussing the issues, BellSouth believes that it has come to better understand the concerns of the other parties, and BellSouth is prepared to address those concerns through its testimony in this case. In addition, these discussions have brought into focus the specific areas that the parties should address in a hearing.

As a result of the settlement discussions, BellSouth has concluded that, at its heart, this docket is about finding the appropriate ways for carriers in Tennessee to deliver discounts to business customers in response to the competition that has developed for certain business services. In the past, BellSouth has delivered those discounts using CSAs. In light of the Attorney General's letter and the concerns addressed therein, BellSouth has concluded that it is time for the TRA to address whether the five business services identified above should be exempted from the tariffing requirements and exempted from the price discrimination prohibition contained in Title 65, Chapter 5, Part 2. To the extent questions have been raised about the extent to which CSAs can be used to depart from tariff prices in response to competition, BellSouth believes that the most productive response to those concerns is to evaluate the competitive landscape for these services. BellSouth believes that, when the evidence is presented, the TRA will conclude that competition exists for these business services in a fashion that mandates that the TRA exempt those services from the tariffing and price discrimination requirements addressed above.

Respectfully submitted,

BELLSOUTH TELECOMMUNICATIONS, INC.

By: 

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(615) 214-6311

PROPOSED SCHEDULE FOR DISCOVERY

- A. Discovery requests shall be issued by Friday, October 25, 2002.
- B. Responses to discovery requests would be served on Friday, November 8, 2002.
- C. Direct testimony and proposed criteria shall be filed on Friday, November 22, 2002.
- D. Rebuttal testimony shall be filed on Tuesday, December 3, 2002.
- E. A hearing would be conducted during the week of December 9, 2002.
- F. Post-hearing briefs would be submitted by December 20, 2002.
- G. Reply briefs or reply comments would be filed by January 6, 2003.

(f) Any universal service support mechanism created pursuant to this part shall hereafter be known as the universal service program. To implement any such universal service program, there is established a special reserve account in the state's general fund to be funded and allocated in accordance with the provisions of this section and rules promulgated by the authority. Such fund shall be known as the universal service program support mechanism fund. Moneys from the fund may be expended in accordance with such universal service program. Any moneys deposited in the fund shall remain in such account until expended for purposes consistent with such program and shall not revert to the general fund on any June 30. Any interest earned by deposits in such account shall not revert to the general fund on any June 30 but shall remain in such account until expended for purposes consistent with the universal service program. [Acts 1995, ch. 408, § 4; 2001, ch. 124, § 1.]

Compiler's Notes. Acts 1995, ch. 305 § 23, which substituted "authority" for "commission" throughout this chapter, is deemed to amend this section, effective July 1, 1996.

Amendments. The 2001 amendment added (f).

Effective Dates. Acts 2001, ch. 124, § 2. July 1, 2001.

Section to Section References. Sections

65-5-207 — 65-5-210 are referred to in § 65-5-210.

This section is referred to in §§ 65-5-208, 65-5-209, 65-5-213.

Attorney General Opinions. Authority's right to retain interest from universal service fund, OAG 98-0177 (8/28/98).

Cited: BellSouth Telecommunications, Inc. v. Greer, 972 S.W.2d 663 (Tenn. Ct. App. 1997).

65-5-208. Classification of services — Exempt services — Price floor — Maximum rates for non-basic services. — (a) Services of incumbent local exchange telephone companies who apply for price regulation under § 65-5-209 are classified as follows:

(1) "Basic local exchange telephone services" are telecommunications services which are comprised of an access line, dial tone, touch-tone and usage provided to the premises for the provision of two-way switched voice or data transmission over voice grade facilities of residential customers or business customers within a local calling area, Lifeline, Link-Up Tennessee, 911 Emergency Services and educational discounts existing on June 6, 1995, or other services required by state or federal statute. These services shall, at a minimum, be provided at the same level of quality as is being provided on June 6, 1995. Rates for these services shall include both recurring and nonrecurring charges.

(2) "Non-basic services" are telecommunications services which are not defined as basic local exchange telephone services and are not exempted under subsection (b). Rates for these services shall include both recurring and nonrecurring charges.

(b) The authority, after notice and opportunity for hearing, may find that the public interest and the policies set forth herein are served by exempting a service or group of services from all or a portion of the requirements of this part. Upon making such a finding, the authority may exempt telecommunications service providers from such requirements as appropriate. The authority shall in any event exempt a telecommunications service for which existing and potential competition is an effective regulator of the price of those services.

(c) Effective January 1, 1996, an incumbent local exchange telephone company shall adhere to a price floor for its competitive services subject to such

determination as the floor shall equal the rates for essential providers plus the cost of the service. When exempt a service or telephone company as appropriate, also subsidization, preferential pricing, price other anti-competitive (d) The maximum 6, 1995, shall not exceed § 9.]

Compiler's Notes. Authority which substituted "authority" throughout this chapter this section, effective July

65-5-209. Price services are just and set forth in this section authority shall ensure and non-basic services for each incumbent

(b) An incumbent's application under collect only such rates by this section and non-discrimination

(c) The authority's application of an incumbent in a price regulation plan, the telephone services deemed affordable earned rate of return report as audited by less than the company's time of the company's earned Authority 3.01 report (j) is greater than authority shall initiate initial rates on which initiate such a rate-company's rate base and cap Regulatory Authority

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determination as the authority shall make pursuant to § 65-5-207. The price floor shall equal the incumbent local exchange telephone company's tariffed rates for essential elements utilized by competing telecommunications service providers plus the total long-run incremental cost of the competitive elements of the service. When shown to be in the public interest, the authority shall exempt a service or group of services provided by an incumbent local exchange telephone company from the requirement of the price floor. The authority shall, as appropriate, also adopt other rules or issue orders to prohibit cross-subsidization, preferences to competitive services or affiliated entities, predatory pricing, price squeezing, price discrimination, tying arrangements or other anti-competitive practices.

(d) The maximum rate for any new non-basic service first offered after June 6, 1995, shall not exceed the stand-alone cost of the service. [Acts 1995, ch. 408, § 9.]

Compiler's Notes. Acts 1995, ch. 305 § 23, which substituted "authority" for "commission" throughout this chapter, is deemed to amend this section, effective July 1, 1996.

Section to Section References. This section is referred to in §§ 65-5-207, 65-5-209.

Cited: BellSouth Telecommunications, Inc. v. Greer, 972 S.W.2d 663 (Tenn. Ct. App. 1997).

65-5-209. Price regulation plan. — (a) Rates for telecommunications services are just and reasonable when they are determined to be affordable as set forth in this section. Using the procedures established in this section, the authority shall ensure that rates for all basic local exchange telephone services and non-basic services are affordable on the effective date of price regulation for each incumbent local exchange telephone company.

(b) An incumbent local exchange telephone company shall, upon approval of its application under subsection (c), be empowered to, and shall charge and collect only such rates that are less than or equal to the maximum permitted by this section and subject to the safeguards in § 65-5-208(c) and (d) and the non-discrimination provisions of this title.

(c) The authority shall enter an order within ninety (90) days of the application of an incumbent local exchange telephone company implementing a price regulation plan for such company. With the implementation of a price regulation plan, the rates existing on June 6, 1995, for all basic local exchange telephone services and non-basic services, as defined in § 65-5-208, are deemed affordable if the incumbent local exchange telephone company's earned rate of return on its most recent Tennessee Regulatory Authority 3.01 report as audited by the authority staff pursuant to subsection (j) is equal to or less than the company's current authorized fair rate of return existing at the time of the company's application. If the incumbent local exchange telephone company's earned rate of return on its most recent Tennessee Regulatory Authority 3.01 report as audited by the authority staff pursuant to subsection (j) is greater than the company's current authorized fair rate of return, the authority shall initiate a contested, evidentiary proceeding to establish the initial rates on which the price regulation plan is based. The authority shall initiate such a rate-setting proceeding to determine a fair rate of return on the company's rate base using the actual intrastate operating revenues, expenses, rate base and capital structure from the company's most recent Tennessee Regulatory Authority 3.01 report as audited by the authority staff pursuant to

CERTIFICATE OF SERVICE

I hereby certify that on October 21, 2002, a copy of the foregoing document was served on the parties of record, via the method indicated:

- Hand
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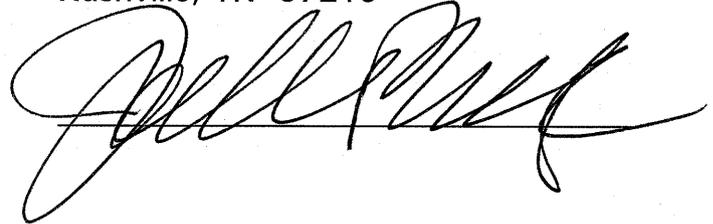
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A large, stylized handwritten signature in black ink, appearing to read 'Timothy Phillips', is written over a horizontal line.